

**BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D. C.**

In the Matter of)	
Request for Review Suspension of High Cost)	CC Docket No. 96-45
Universal Service Support Payments)	

**Comments of the Public Service
Commission of the State of Missouri**

The Public Service Commission of the State of Missouri (“MoPSC”) offers the following comments in response to the Federal Communication Commission’s (“Commission”) Public Notice released in the above docketed case on December 17, 2004. Through the Public Notice, the Commission seeks comment on an appeal filed by Cass County Telephone Company, LLC (Cass County) of a November 5, 2004 decision issued by the Universal Service Administrative Company (USAC) that suspends and withholds high-cost support payments to Cass County.

Cass County Appeal

In its appeal, Cass County submits that there was no basis for the MoPSC decision not to issue the certification for 2005. Cass County states the MoPSC has procedures in place for carriers to demonstrate eligibility for funding, and Cass County submitted the requested information, complying with the MoPSC certification procedures. Cass County notes the MoPSC failed to certify only Cass County and one other carrier, without offering findings or justification for singling them out for disparate treatment. Finally, Cass County states the letter declining to certify is inconsistent with the Commission’s rules because the rules require a State to certify that all federal high cost support provided to a carrier “will be used” for the purposed intended. Instead, Cass

County states the MoPSC referred to its ongoing inquiry into Cass County and the “*current*” use of the support without explaining its deviation from the Commission rules.

The MoPSC takes issue with these assertions. The Commission’s rules only require that a state commission provide an affirmative statement that the state commission certifies that a company will use the high cost support it receives from the Federal Universal Service Fund in accordance with section 254(e) of the Telecommunications Act of 1996 (47 USC §254(e)). The Commission’s rules do not require a state commission to justify its decision or support its decision with evidence. In fact, the Commission’s rules do not require notice that a state commission declines to provide the certification. The MoPSC submitted its letter as a courtesy to inform the Commission that it was conducting further inquiry and that the MoPSC was anticipating the receipt of a third party audit.

As will be explained in these comments, the MoPSC’s withholding of its certification was neither unjustified nor unlawful, but based on careful review of information provided by Cass County in a like manner to every other Missouri incumbent local exchange carrier, as well as a careful review of information received through contacts with Cass County personnel and through responses to discovery requests in light of federal allegations and/or indictments and complaint against Cass County executives and owners.

State certification

Section 54.314 of the Commission’s rules sets forth the requirements for state certification of rural carriers and eligible telecommunications carriers in rural areas for receipt of federal universal service funds. These requirements follow:

States that desire rural incumbent local exchange carriers and/or eligible telecommunications carriers serving lines in the service area of a rural incumbent local exchange carrier within their jurisdiction to receive support pursuant to §54.301, 54.305, and/or 54.307 and/or part 36, subpart F of this chapter must file an annual certification with the Administrator and the Commission stating that all federal high-cost support provided to such carriers within that State will be used only for the provision, maintenance, and upgrading of facilities and services for which the support is intended. Support provided pursuant to §54.301, 54.305, and/or 54.307 and/or part 36, subpart F of this chapter shall only be provided to the extent that the State has filed the requisite certification pursuant to this section.

c) *Certification format.* A certification pursuant to this section may be filed in the form of a letter from the appropriate regulatory authority for the State, and shall be filed with both the Office of the Secretary of the Commission clearly referencing CC Docket No. 96–45, and with the Administrator of the high-cost universal service support mechanism, on or before the deadlines set forth in paragraph (d) of this section. If provided by the appropriate regulatory authority for the state, the annual certification must identify which carriers in the State are eligible to receive federal support during the applicable 12-month period, and must certify that those carriers will only use support for the provision, maintenance, and upgrading of facilities and services for which support is intended. A State may file a supplemental certification for carriers not subject to the State's annual certification. All certificates filed by a State pursuant to this section shall become part of the public record maintained by the Commission.

Rural incumbent local exchange carriers not subject to the jurisdiction of a state or eligible telecommunications carriers not subject to the jurisdiction of a state serving lines in the service area of a rural incumbent local exchange carrier are required to file, with the Commission and USAC, a sworn affidavit executed by a corporate officer attesting to the use of the support for the provision, maintenance, and upgrading of facilities and services for which support is intended.

MoPSC Certification Process

In response to the Commission's rule, the MoPSC developed and continues to modify its process for certifying rural incumbent local exchange carriers and eligible

telecommunications carriers. Consistent with the Commission's rules for carriers not subject to state jurisdiction, in 2001, the MoPSC required Missouri rural incumbent local exchange carriers and eligible telecommunications carriers to submit sworn affidavits executed by a corporate officer attesting to the proper use of federal USF high cost support.

In an effort to gain more support for its certifications, the MoPSC directed its Staff to work with the industry to develop a process whereby carriers receiving high cost support would submit documentation of the use of the high cost support for the provision, maintenance and upgrade of facilities and services for which that support is intended. Staff's recommended process was approved by the MoPSC on July 9, 2002.¹ A copy of the MoPSC's order is attached as Exhibit 1 for the Commission's reference. The MoPSC used this process for the next two years. Identifying a need for further justification from Missouri companies prior to certification, the MoPSC directed its Staff to once again work with the industry and make recommendations on an appropriate process to provide assurance to the MoPSC that Missouri companies were using the federal high cost support for the purposes intended. In April 2004, the MoPSC approved a new process, which was implemented for the October 2004 certification process. A copy of documentation on the 2004 process is attached as Exhibit 2.

As the Cass County appeal indicates, Cass County submitted its documentation pursuant to the MoPSC certification procedure, with its verified affidavit signed by Mr. Kenneth Matzdorff, President, on August 24, 2004. However, as will be discussed in more detail, allegations made in a federal investigation including Cass County Telephone

¹ *In the Matter of the Investigation into Certification for Federal Universal Service Funds*. Case No. TO-2002-347. Order Establishing Certification Procedure.

Company implicated owners and executives of Cass County, causing the MoPSC to request additional information from Cass County, which ultimately resulted in the MoPSC's decision to decline certification for funding year 2005, pending further inquiry and anticipated receipt of a third party audit.

Additional Certification Documentation

First and foremost, it should be noted, that Cass County was not the only company from which the MoPSC required additional information prior to determining what action to take with regard to certifying that the company would use federal high cost support in accordance with section 254(e) of the Telecommunications Act of 1996. On February 14, 2004, an article in the Kansas City Star noted the implication of Kenneth M. Matzdorff in a nationwide phone and Internet scheme linked to organized crime. Mr. Matzdorff, who held officer positions with several Missouri telephone companies, was cited as holding or having held positions "with a web of little-known Missouri and Kansas companies" including firms "that figure prominently in a criminal indictment returned earlier [that] week in new York"². The article noted that the firms USP&C, Inc. and Local Exchange Company, LLC (LEC, LLC) "were at the heart of the scheme according to the indictment and other court documents." Mr. Matzdorff and LEC, LLC both have ownership and executive interests in Cass County.

On July 29, 2004, after months of related activities, the MoPSC directed its Staff to investigate issues surrounding the allegations raised by the criminal indictments and the complaint and arrest warrant against Mr. Matzdorff. Subsequently, the complaint against Mr. Matzdorff was dismissed without prejudice. However, in January 2005, Mr.

² "Belton exec linked to phone scan. Kenneth Matzdorff has ties to firms listed in indictment." Kansas City Star, Page C1. February 14, 2004.

Matzdorff pled guilty to various federal charges, including a charge based in part on defrauding the federal Universal Service Fund (Exhibits 3 and 4).

As part of its investigation, Staff sent several discovery requests seeking responses on issues related to the allegations in the federal indictments and complaint. Through responses to the discovery requests, Staff identified five Missouri telephone companies with either ownership or business relationships that involved Mr. Matzdorff and/or LEC, LLC. Staff issued additional discovery requests to these five companies seeking information on inter-company transactions and use of federal high cost support. On or about August 27, 2004, Staff contacted each company directly or through local counsel inquiring as to the impact on the company and its customers if the MoPSC did not certify the company for federal universal service fund high cost support by October 1, 2004. Cass County responded with its estimated impact on September 2, 2004.

Audited financial statements for three of the five companies, in addition to information provided in response to discovery requests, provided Staff with support for a positive recommendation to the MoPSC for certification of three of the companies in question. The lack of audited financial statements, in addition to concerns raised through discovery request responses resulted in Staff's recommendation to the MoPSC and ultimately the MoPSC's decision to decline to certify that Cass County Telephone Company and Cass County would use federal high cost support in accordance with section 254(e) of the Telecommunications Act of 1996; however, the MoPSC stated, "it is conducting further inquiry of these companies and awaiting the receipt of a third party audit." Representatives of Cass County Telephone Company and Cass County advised the MoPSC Staff that they anticipated the third party audits would be available by

Thanksgiving. As of the date of these comments, the MoPSC Staff has not received the third party audit of Cass County.

Cass County Further Inquiry

Following is a summary of relevant information the MoPSC and its Staff have obtained and reviewed related to the inquiry into the operations of Cass County.

Cass County Telephone Company Limited Partnership is a Maryland limited partnership, formed to own the local telephone system in Cass County, Missouri. LEC L.L.C. owns 99% of the limited partnership. At least until 2005, based on an unexecuted service agreement, LEC LLC charged Cass County an amount in the seven-figure range annually to provide services. On February 5, 1999, Mr. Matzdorff filed a “Registration of Fictitious Name” with the Missouri Secretary of State for Cass County to do business under the name CassTel.

There was a Kansas City grand jury investigation of Mr. Matzdorff’s activities reported in a November 3, 2004 *Kansas City Star* article. The article states that several “Cass County Telephone executives have been subpoenaed to testify before the grand jury, which appears to be focusing on money that the company, better known as CassTel, received from a federal program designed to assist high-cost and rural telephone service providers.” Cass County Telephone Company’s executive, accounting, financial, and purchasing functions are performed by LEC LLC employees.

The MoPSC Staff’s investigation has revealed that the level of Cass County Telephone Company’s costs can influence the amounts that the company receives from the National Exchange Carrier Association (NECA) revenue pool and from the Universal Service Fund. The following section from Cass County’s 2002 annual report describes

the relationship of the Cass County's costs to the amount of NECA pool revenues that it receives and details regarding Universal Service Fund payments it receives:

a. **Network Access Service Revenue**

Revenues from interstate network access services are received through tariffed access charges filed by the National Exchange Carrier Association (NECA) with the Federal Communications commission (FCC) on behalf of its member companies. These access charges are billed by the Partnership to the interstate long distance carrier and pooled with like revenues from all NECA member companies. **The portion of the pooled access charge revenue received by the Partnership is based upon its actual cost of providing interstate long distance service, plus a return on investment dedicated to providing that service.** These revenues for the year ended December 31, 2002 and 2001 are subject to final review and approval by NECA. Partnership policy is to record any adjustments of these revenues in the period in which the adjustments become known. Management believes that revenues recorded at December 31, 2002 and 2001 represent reasonable estimates of the final amounts to be received under the agreement referred to in this paragraph. (Emphasis added)

Cass County includes its USF payments in network access and long distance service revenues. For the years ended December 31, 2002 and 2001, payments received from the fund approximated 24% and 23%, respectively, of operating revenues. Federal Universal Service Fund payments provide assistance with the cost of providing telecommunications service to high cost areas.

Cass County Telephone Company has received \$15,544,295 from the federal Universal Service Fund since 1996. The challenge is to prevent excessive costs from being incurred or fraudulent claims of costs being made under the guise of the high costs required to provide service to a specific area. Transactions with affiliated or related parties are high risk with regard to cost minimization, because of the absence of the normal safeguards found in arms-length transactions between unrelated parties; each acting in their own self interests. At least until January 2005 Cass County Telephone

Company had two officers with authority to approve purchases or fund disbursements that also have a separate business relationship with third party vendors that have engaged in business transactions with Cass County that total more than \$10,000 annually. These individuals are Kenneth Matzdorff and Rebecca Matzdorff.

In its investigation the MoPSC Staff examined third-party vendors related to Kenneth or Rebecca Matzdorff that received more than \$10,000 from Cass County in one year. The MoPSC Staff's examination of affiliated or related party transactions is incomplete at this time. Two affiliates, LEC, LLC and New Florence Telephone Company, that are known to conduct business with Cass County were asked through discovery to describe the safeguards that they use when entering into transactions with affiliates. Cass County objected to the request as vague, overbroad and seeking information not in the possession and control of the Company. Cass County also stated that the safeguards employed by these companies are irrelevant to Cass County's regulated operations despite the amount of the payments that Cass County is making to these affiliates. Cass County has done business with other companies at a level greater than \$10,000 annually. At this time, the MoPSC Staff is unsure whether these companies are related to any of the owners or employees of LEC, LLC. Some of the entities that Cass County did business with could not be found through a search of the Missouri Secretary of State website, (i.e., they appear not to have authority to do business in this state).

Cass County identified the safeguards that it used regarding affiliated transactions or with entities that have a business relationship with company employee(s) in the following statementⁱ:

[Cass County] used various methods to review transactions with affiliated entities. These methods included independent audits by third parties; comparison of charges of similarly situated companies and price negotiations conducted by Cass County employees who have no financial interest in the resulting price.

Cass County does not hire its independent auditor. LEC, LLC hires the independent auditor. The prior independent auditor has suspended provision of audit services to Cass County and others. Cass County submitted a proprietary data request response on November 30, 2004 that contained the letter from the prior independent auditor suspending any additional audit or professional services to LEC, LLC, Cass County Telephone Company LP, and CassTel LD until the current LEC, LLC ownership issues are resolved. Additional highly confidential data shows that Cass County employees do not hold positions that one would expect to be capable of or have the time to perform a comparison of charges of similarly situated companies or to conduct price negotiations. It appears that such work activities would likely be performed by LEC, LLC employees.

Cass County On-Going Investigation

On January 14, 2005, the MoPSC issued an Order Establishing Investigation Case in Case No. TO-2005-0237. The order directed the MoPSC Staff to “investigate all matters pertaining to the operations of two Missouri telecommunications utilities, Cass County Telephone Company (“Cass County”) and New Florence Telephone Company (“New Florence”)), including “a financial review concerning the receipt and disbursement of Universal Service Funds”. A copy of this order is attached as Exhibit 5.

On January 18, 2005, Mr. Matzdorff waived his right to a grand jury and pleaded guilty to a federal charge of conspiracy to commit mail and wire fraud. Mr. Matzdorff admitted he participated in a conspiracy from January 1998 to July 2004 to defraud the

Universal Service Administrative Company and the National Exchange Carriers Association. According to the federal information, Mr. Matzdorff and others inflated Cass County expenses in order to qualify for \$8.9 million in unwarranted subsidies and disbursements. (See Exhibits 3 and 4)

On January 25, 2005, Richard T. Martino and Daniel D. Martino, two controlling owners of LEC, LLC, were indicted by a federal grand jury for participating in a nearly \$9 million conspiracy to commit mail and wire fraud. Count One of the federal indictment alleges the Martinos also participated in a conspiracy to defraud USAC and NECA. (See Exhibits 6 and 7)

Summary

As these comments demonstrate, the MoPSC had sufficient basis upon which to decline to certify by October 1, 2004, that Cass County would use its Federal Universal Service Fund high cost support in accordance with section 254(e) of the Telecommunications Act of 1996 (47 USC §254(e)). Cass County was not singled out and subjected to a level of scrutiny not applied to other similarly situated companies. MoPSC investigations, based on the allegations in federal indictments and complaint, identified five companies with business or ownership relationships with entities named in the indictments and complaint. Further investigation resulted in the MoPSC certifying that three of the five companies would use their high cost support in accordance with section 254(e) of the Telecommunications Act of 1996 (47 USC §254(e) after concerns had been minimized. As previously indicated, the MoPSC continues its investigation into Cass County based on subsequent discovery, and now a formal case. Should additional investigation show that Cass County will use the Federal Universal Service Fund high

cost support in accordance with section 254(e) of the Telecommunications Act of 1996
(47 USC §254(e), the MoPSC will submit its certification letter at that time.

Respectfully submitted,

Natelle Dietrich
Regulatory Economist

/s/ Nathan Williams
Nathan Williams
Senior Counsel
MoBar No. 35512
Missouri Public Service Commission
P. O. Box 360
Jefferson City, MO 65102
(573) 751-8702 (Telephone)
(573) 751-9285 (Fax)
e-mail: nathan.williams@psc.mo.gov

ⁱ November 30, 2004 response to Staff Data Request No. 24.